Summary of the Operation Performance Evaluation Review

The project

In March 2001 the European Bank for Reconstruction and Development ("the Bank") approved a €36 million sovereign-guaranteed loan ("the Loan") to the Client, a state-owned oil and gas monopoly established in the 1960s. As a vertically integrated oil and gas company, activities included exploration and the production of crude oil, refining, and wholesale and retail of oil and oil derivative products. As part of the Client's cost reduction and efficiency improvement plan, the Loan was formulated to finance the rehabilitation of ageing facilities in the refineries in order for the Client to improve environmental performance and operational efficiency. The loan proceeds were allocated to 17 components mainly to "reduce the air emissions and wastewater discharges". During the project implementation, the Client was faced with two major events: (i) privatisation; and (ii) the prospect of European Union ("EU") accession thus requiring compliance with EU environmental/health and safety ("H&S") directives as well as the European standard product quality. These moves let the Client focus on what they were implementing and made it realise the genuine value of the Project. The components were quite fragmented, with some 17 items spread over three project sites. A summary of the project components is given as follows.

Project components	Category/status
Repair of sewer system	Ongoing(from Client's funds)
Revamp of tank farms	Ongoing (from Client's funds)
Sea water protection barriers	Mitigation of sea water contamination
Oily waste treatment	Waste management
Revitalisation of hydrosulphurisation plant	Ongoing from Client's funds
Air emission monitoring devices	Pollution monitoring
Waste landfill	Suspended/cancelled
Sour water stripping unit	Part of low-sulphur product production cycle
Bitumen oxidation unit	Sealed facility for bitumen production
Furnace in vacuum distillation plant	Scope modified and implemented by INA's own funds
Equipment for hydrodesulphurisation process	Part of low-sulphur product production cycle
Oil separators for storm water	Wastewater treatment
Water landfill	Waste management

Project rationale

After the post-war recovery at the end of 1990s, the Government faced an important agenda to reform the oil and gas sector through the Client's deregulation and privatisation. The Government and the Client planned a new investment to restore ageing facilities and to increase the economic and financial viability of the Client prior to privatisation by improving operational efficiencies. The Bank tried to take a more value-added approach at the inception stage. Reducing pollution in respect of the EU directives, although compliance was remote, would conform to what the Bank was seeking at that time. The Project was thus fully in line with the relevant strategy and policy. A comprehensive environmental mitigation scope was placed on the table at the project inception, some of which was, however, later replaced with more commercial components, reflecting the Client's project concept prior to the Board approval in 2001.

Achievement of objectives

The Operation Performance Evaluation Review (OPER) Team has assessed the fulfilment of objectives ***Good.***

- **Upgrade existing wastewater treatment, hazardous waste management and treatment facilities at Client's refineries and exploration and production division for a total cost estimated at €36 million:** This objective has been largely achieved as the improvements were made in the areas mentioned above except for upgrade of the wastewater treatment, which was taken out of the project scope during appraisal.
- **Achieve annual operational savings of US$ 2.5 million from the programme implementation:** It is hard to assess the fulfilment of this objective as it has not been monitored. Due to incomplete substantiation, the OPER Team considers this objective to be partly achieved.
- **Significantly reduce soil and water contamination of one of the most scenic parts of the country's coastline and bring the environmental performance closer to full compliance with EU environmental regulations:** This objective was presumably achieved as the contamination of underground and sea waters must have been reduced as a result of the installation of floating barriers and skimmers.
- **Support a restructuring of a state oil and gas company and make it more competitive and compliant with the EU environmental standards prior to the EU accession:** This objective is achieved.

Overall assessment

The Project was formulated in 1998 and brought for Board considerations in 2001. At that time, the Government and the Client were seeking the right approach to restructure this monopoly in the gas and oil industry by improving production efficiencies. The Client was largely exposed to world oil price fluctuation and foreign exchange risks, thus financials were largely vulnerable. While environmental awareness was starting to rise, changes in this area were still quite low both for the Client and also the country. With the Loan, the Bank enhanced the Client's commitment to making environmental improvements mainly in the areas of water contamination, which could reduce the environmental liabilities and could enhance the corporate value for the upcoming privatisation. The Bank's additionality ***is verified in all respects***.

In 2001 the approved project scope included several components related to the production of low-sulphur fuel products. This was the result of the new vehicle emission standard fuel quality announced by the European Commission in 1999. The implementation was delayed slightly but just completed by 2007. The achievement of the objectives is assessed as ***Good***, as the completed components have delivered the expected benefits. During the implementation period, the Client experienced privatisation and tightened environmental regulations in view of the EU accession. In 2005 new management launched a Modernisation Programme, which included the completion of the Project, preparation for higher emission standard fuel production and compliance with the EU environmental directives by 2013. The Client has changed significantly in these internal and external moves for new standards in the competitive market economy. The Client's transformation has resulted mainly from the privatisation and the pressure from the environmental authorities. Nevertheless the Project had paved the way to necessary transition. Therefore, the transition impact of the Project is considered ***Good***. The risks are assessed ***Medium***, lying in a slow-down of the current modernisation programme under the influence of the crisis, thereby retracting the Client's rising environmental awareness. Increasing competition has created challenges for the Client, who would need to tackle efficiency improvements in production and management more rigorously. Company financials are considered ***Satisfactory***. The return on the Bank's Loan is assessed ***Good***, covering all direct and indirect costs.

During this turbulent decade, the Client's views on the environment have significantly changed. Outside the Project scope, the Client spent a considerable amount of capital expenditure on its own for environmental mitigations. They have become more aware that the oil and gas industry must live harmoniously with the environment. A series of environmentally friendly corporate publications enhanced corporate image and marketing. Compliance with the EU directives remains the target for the future. The environmental performance is assessed ***Good***. The Project has made ***Some*** changes to the large refineries, mostly positive. From 2001 to 2008 emissions and contaminations have indicated a downward trend at the refineries owing partly to the project components. Bank handling is a mixture of good/poor practices and positive/negative outcomes, and has therefore turned out ***Satisfactory*** in the end. While the Bank's endeavours to bring the country's monopoly into their first-time International Financial Institution (IFI) financing should be commended, a certain slackness is found in the internal documentation, such as a basic mistake at the Board appraisal document and further reporting, and weakening post-procurement monitoring.

Transition impact and the Bank's additionality

Transition impact of the Project is assessed as ***Good***. At all levels, including corporate, industry and the economy at large, the Project has delivered a new standard and better business practices through the implementation of upgrading. It should be noted that the Client's heightened environmental awareness is a credit not only to the Project but also significantly to the regulatory framework, that is the relevant EU directives and the enforcement power of the Ministry of Environment.

Additionality: The Bank's additionality was fully justified from financial and design functionality standpoints. At the time of appraisal, the Client struggled with increasing oil and gas prices and the restriction on fuel products. The need for external financing for capital expenditure was strong and justified the Bank's intervention. Moreover, financing for the environmental improvements was fully in line with the Bank's mandate. Therefore, additionality is ***Verified in all respects***.

Bank handling

Bank handling is assessed overall as ***Satisfactory.*** The rating is the composite assessment at several stages of the project cycle: (i) project origination and formulation; (ii) due diligence; (iii) internal and external documentation up to signing; (iv) tendering and procurement and consultant recruitment; (v) handling of client reports; (vi) review of lending conditions/waiver/operation change/amendment processing; (vi) implementation monitoring and internal report generation including the expanded monitoring report ("XMR"). The Bank's performance is reviewed in terms of quality of work, operational integrity and transparency, covenanting techniques and mandate reflections, policy dialogue, troubleshooting ability, project filing, team accountability, continuity and responsiveness of the Operation Team.

Main OPER issues and lessons learned

Issue: Project design and implementation of the Environmental Loan. Reflecting the mandate in the project design is not only the major requirement in the international community but also an enhanced added value that the institution can offer. While money is fungible, this feature distinguishes the multilateral development bank's financing from commercial lending, and requires higher socio-economic returns. **Lesson learned: What would benefit the client in the long term conforms to the Bank's overarching objectives.** In this project, the Bank merely provided the financial means to procure the components suited to the client's immediate needs for environmental mitigation and new product lines, while the project concept was limited to the environment. Conceding to the industry's priority might reduce the added value of the multilateral development financing, thereby preventing the project from fully benefiting the client in the long term.

Issue: Transformation of an industry monopoly through privatisation
Lesson learned: External pressures are limited to turning a large organisation around, while internal changes are more powerful drivers for transformation. A large monopoly with strong ties to the government was hard to change despite policy dialogues with international agencies. In this project, the transformation was finally undertaken by a new owner from a similar industry in the region. The transformation is accepted by the monopoly in a receptive manner as the new owner also underwent the same transitional experience towards a market economy, which created shared feelings and a readiness for changes.

Issue: Empowerment of the Environmental Authority
Lesson learned: The Environmental Authority is a vital vehicle for passing transition on to industries, and this prompt empowerment is realised by the citizens' support and heightened awareness. In this project, the Environmental Ministry's authority quickly increased after the prospect of accession to the European Union. Its sanction rights and inspection norms have significantly been strengthened as people and industries support the protection of their natural assets, which are considered the country's treasures.

Issue: Incorporating the environmental cost into the market mechanism
Lesson learned: Higher standard product quality is an effective tool for incorporating the environmental cost into the pricing mechanism when imposed on the industry. In this project, the borrower company directed its resources to producing the required quality products. It appears that the requirement for product standard is more powerful than the pollution threshold enforced by penalties. The Project should be designed to encourage a good balance of priority matters that concern the Bank's mandate.

Recommendations for a follow-on investment: Public financing has never been scarcer than for now. Rather than justifying and maintaining the same fashion of structuring the project, the Bank might need to learn from lessons, so that the quality of the project could improve, fulfilling the overarching mission of the multilateral development bank and could therefore enhance the additionality of the Bank. The OPER Team has drawn a few major recommendations for consideration wherever possible; if the Bank becomes engaged in a follow-on financing to the Client:

- formulation of focused project components under a clear project concept to avoid a "large shopping bag" deal
- preparation of a fully fledged environmental action plan, including environmental capacity building actions well coordinated with the Client's ongoing and future Modernisation Programme
- environmental baseline data to be collected with regard to the project components
- submission of an annual environmental monitoring report to be required
- based on an energy efficiency audit, certain target indicators to be covenanted if necessary
- efficiency- and productivity-oriented measurable financial and transition covenants
- review of the Bank-financed components in the oil and gas treatment site, as neither due diligence nor implementation monitoring was conducted at this project site.